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(54) Title: SYSTEM AND METHOD GENERATING COMPLIANCE RULES FOR TRADING SYSTEMS

(57) Abstract

A system for generating compliance rules. The system comprises a compliance rule memory (19) for storing compliance rules; generation (26, 29) means for generating virtual trading histories, virtual trading behaviours and/or virtual compliance rules; selection means (30) for selecting virtual trading histories, virtual trading behaviours and/or virtual compliance rules; and updating (30) means for storing virtual compliance rules in the compliance rule memory, wherein the virtual compliance rules have been developed with reference to the selected virtual trading histories, virtual trading behaviours and/or virtual compliance rules.

SYSTEM AND METHOD GENERATING COMPLIANCE RULES FOR TRADING SYSTEMS

The present invention relates to a method and system
for monitoring transactions carried out in a trading
system. The present invention also relates to a method
and system for generating trading behaviours.

Financial trading systems, such as those used in the
stock-market, money-market and derivatives-markets, make
extensive use of computer systems to capture and
manipulate information about the markets and the trades
performed. Because of the complexity of markets and
products and the enormous volumes of data, sophisticated
computer systems are used to assess and manage the risks
involved. An example of such a system is the OBERON
system which allows dealers and their managers to assess
their exposure to various forms of financial risk, and
the OBERISK system which consolidates information from
various financial trading systems to provide information
about capital adequacy and value at risk. Given a set of
Compliance Rules which can be expressed in computerisable
form, it is relatively straightforward to build a
computer system which scans the available data and looks
for apparent breaches of these Rules, as for example in
the BT CREDIT CARD FRAUD MONITORING SYSTEM. However,
because of the complexity of such markets and the large
sums of money involved, from time to time banks and other
organisations suffer substantial losses when one or more
ingenious individuals exploit loopholes in the rules to
conduct trades which are apparently successful and
compliant but which prove to have been disastrous
(Barings, Sumitomo, GE, NatWest etc…). Once these
loopholes have come to the attention of the companies
they are usually blocked, but by which time it is too
late.

In accordance with a first aspect of the present
invention there is provided a system for generating
compliance rules, the system comprising
a compliance rule memory for storing compliance rules;

generation means for generating virtual trading
histories, virtual trading behaviours and/or virtual
compliance rules;

selection means for selecting virtual trading histories,
virtual trading behaviours and/or virtual compliance
rules; and

updating means for storing virtual compliance rules in
the compliance rule memory, wherein the virtual
compliance rules have been developed with reference to
the selected virtual trading histories, virtual trading
behaviours and/or virtual compliance rules.

In accordance with a second aspect of the present
invention there is provided a method of generating
compliance rules, the method comprising

generating virtual trading histories, virtual trading
behaviours and/or virtual compliance rules;

selecting virtual trading histories, virtual trading
behaviours and/or virtual compliance rules; and

storing virtual compliance rules in the compliance rule
memory with reference to the selected rules, histories or
behaviours.

The compliance system generates and selects virtual
trading histories or behaviours which may not yet have
been observed in the real trading system and which have
an appreciable level of apparent irregularity, eg. they
may be unusual or unconventional in some way (indicating
that they may be fraudulent) or they may carry an
unacceptable level of risk. Alternatively the compliance
system generates and selects virtual compliance rules.

The present invention provides a system which can
detect irregular trading histories before or soon after
they are carried out in the real trading system. This is
achieved by generating and selecting irregular trading
histories or behaviours in a virtual trading environment.
The selected irregular trading histories or behaviours
can then be reviewed by a human compliance officer who
can formulate appropriate new virtual compliance rules.

The present invention effectively provides a virtual
trading system - ie. the compliance rule memory is
continually updated with reference to the performance of
the virtual histories, behaviours or rules in a virtual
trading system.

The virtual trading system may be separated either
temporally or physically away from the real trading
system, as discussed below.

That is, in one example the same computers are used
to process transactions in the real trading systems and
to generate the virtual compliance rules. In this case
these two functions are typically performed at different
times, ie. the functions of the virtual trading system
are performed when the real trading system (or a
particular trading computer which makes up the trading
system) is not presently being used for trading. In this
case the virtual trading system is effectively temporally
separated from the real trading system. This maximises
use of the processing power of the real trading system
and at the same time ensures that the performance of the
real trading system is not degraded. Alternatively the
two functions may be run simultaneously but with the
virtual compliance rule function at a lower priority.

In a second example, the compliance system may be
created physically located in a separate computer. In
this case the virtual trading system is effectively
physically separated from the real trading system. The
compliance system continually updates the compliance rule
memory with reference to the behaviour of a virtual
trading system in which virtual trading histories or
behaviours are cultivated by the cultivation means. This
ensures that the performance of the real dealing system
is not degraded.

Typically the virtual trading histories each
comprise a sequence of transactions, and the virtual
trading behaviours each comprise a set of rules relating
to trading strategy (an example of which is given by the

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"tigers" illustrated in Figure 5). The virtual
compliance rules comprise rules which determine whether a
transaction or sequence of transactions is compliant.

In one example the generation means independently
generates virtual histories, behaviours or rules without
any reference to the real trading system. For example
the virtual trading histories may comprise random
sequences of transactions. However in a preferred
example the system further comprises extraction means for
extracting real trading histories, real trading
behaviours and/or real compliance rules from the real
trading system and inputting them to the generation
means. The preferred example has the advantage that if a
loophole is already being exploited by a rogue trader who
is carrying out transactions in the real trading system,
then the trading histories or behaviours of the rogue
trader will be input to the generation means. This makes
it more likely that the compliance system will generate a
virtual compliance rule which closes the loophole and
identifies the rogue trader, and also ensures that the
histories are more representative of the real trading
behaviour.

Preferably the generation means generates the
virtual histories, behaviours or rules by modifying
initial histories, behaviours or rules in accordance with
a genetic algorithm. Suitable genetic algorithms and
evolutionary programming techniques are discussed in the
reference book "Michaelewicz, Zbigniew; *Genetic
Algorithms + Data Structures = Evolution Programs*; 3rd
Edition Springer, 1996" (hereinafter Michaelewicz). In
this case, the genetic algorithms use "genetic material"
(such as real trading histories from the real trading
system, and/or previously generated virtual trading
histories) to "breed" virtual histories, behaviours or
rules. For instance the genetic algorithm may comprise
selecting a pair of initial histories, behaviours or
rules, and "mating" them by extracting a portion of each

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initial history, behaviour or rule and combining the
extracted portions. The pair of initial histories,
behaviours or rules may be selected randomly from a pool
of initial histories, behaviours or rules. Alternatively
each initial trading history, behaviour or rule may have
an associated "geographic" factor and the pair of initial
histories, behaviours or rules are selected by a
"courtship" process in accordance with their respective
"geographic" factors.

In one example the virtual compliance rules may be
determined by a human compliance officer - ie. the
identification means displays the selected virtual
trading histories or behaviours and the human compliance
officer formulates a suitable virtual compliance rule or
rules. In an alternative example the virtual compliance
rules are determined automatically - ie. the system
further comprises regularisation means for determining
the virtual compliance rules from the selected virtual
trading histories or behaviours (optionally with suitable
human supervision).

In one embodiment the regularisation means generates
initial virtual compliance rules from the virtual trading
histories or behaviours, and modifies the initial virtual
compliance rules in accordance with a genetic algorithm.
Suitable genetic algorithms and evolutionary programming
techniques are discussed in Michaelewicz.

The histories, rules or behaviours are generally
selected on the basis of some predetermined or adaptive
(eg neural network) algorithm. In a preferred embodiment
the selection means comprises scoring means for
determining an apparent level of irregularity of the
virtual trading histories; and

identification means for selecting virtual trading
histories which exceed a predetermined apparent level of
irregularity.

The apparent level of irregularity of the virtual
trading histories may be determined in any suitable way.

Typically the virtual trading histories each comprise a sequence of virtual transactions, and the scoring means assigns an individual apparent level of irregularity to each virtual transaction, assigns a level of corroboration to some of the virtual transactions, and determines the apparent level of irregularity of the virtual trading history in accordance with the individual apparent levels of irregularity and the levels of corroboration.

Typically the scoring means assigns an individual level of irregularity to each virtual transaction by reference to statistical criteria based on the real trading histories carried out on the real trading system.

The generation means may generate virtual dealing histories which do not comply with the current compliance rules. However in a preferred embodiment the generation means only generates virtual dealing histories which comply with the current compliance rules stored in the compliance rule memory.

The virtual dealing histories may be checked against each one of the current compliance rules. However if this is computationally excessive then the virtual dealing histories could be checked against one or more selected current compliance rules. In one embodiment the virtual dealing histories are checked first against the current compliance rule or rules which are most likely to be broken, and second against one or more current compliance rules which are selected stochastically.

In a preferred embodiment the real trading system comprises a plurality of trading computers connected to a common network, and the compliance monitoring system is implemented by one or more of the plurality of trading computers, typically assisted by one or more dedicated compliance computers. This ensures that the computing power available to the compliance monitoring system increases linearly with the computing power available to the real trading system.

In the present invention, the Compliance Rules used
to scan the real trading environment are continually
updated by reference also to the behaviour of a simulated
virtual trading environment (which we call the
Greenhouse), in which Evolutionary Programming techniques
along the lines of those described in Michaelewicz are
used to cultivate trading behaviours which may contain
irregularities and which are not covered by the
Compliance Rules, thereby making it possible for new
Rules to be developed and added to block loopholes.
'genetic material' from the real ('Wild') trading
environment is continually used for breeding 'Cultivated'
trading behaviours in the Greenhouse. This means in
particular that if a loophole is already being exploited
by a trader then the probability of behaviours being
cultivated in the Greenhouse which exploit this loophole
is considerably increased.

The compliance rules in the compliance rule memory
can be used in two ways. In one example the rules are
simply consulted by a human Compliance Officer to enable
him to make a decision on whether a series of
transactions is compliant. In a second example the
system further comprises a compliance monitor which
monitors transactions carried out on a real trading
system with reference to the compliance rules stored in
the compliance rule memory.

In accordance with a third aspect of the present
invention there is provided a system for generating
trading behaviours, the system comprising
a trading behaviour memory for storing trading
behaviours;
breeding means for generating virtual trading behaviours;
growth regulation means for comparing the virtual trading
behaviours with actions of a real trader, and selecting
trading behaviours which correspond with the actions of
the real trader; and

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updating means for storing the selected trading
behaviours in the trading behaviour memory.

In accordance with a fourth aspect of the present
invention there is provided a method of generating
trading behaviours, the method comprising generating
trading behaviours; comparing the trading behaviours with
the actions of a real trader; selecting trading
behaviours which correspond with the actions of the real
trader; and storing the selected trading behaviours in a
trading behaviour memory.

The third and fourth aspects of the invention
generate trading behaviours (ie. a set of rules relating
to trading strategy) which correctly predict the actions
of a real trader.

An example of the invention will now be described
with reference to the accompanying drawings, in which:-

FIG 1 is the overall functional block diagram of the
Trading Irregularity Detection System;

FIG 2 is an example of how these functions might be
distributed between a number of different computers in a
distributed system;

FIG 3 is a schematic flow diagram illustrating the
functions set out in Table 2;

FIG 3A is a schematic flow diagram illustrating a
first alternative to FIG 3;

FIG 3B is a schematic flow diagram illustrating a
second alternative to FIG 3;

FIG 4 is a functional block diagram of an
alternative Trading Irregularity Detection System in
which genetic means are used to devise new compliance
rules;

FIG 5 is a schematic diagram of a system for
generating trading strategies;

FIG 6 is a diagram illustrating a crossover
function;

FIG 7 is a diagram illustrating a breed function;
and

FIG 8 is a diagram illustrating in more detail an
instance of a crossover function;

Figure 9 is a flow diagram illustrating the growth
regulation of a virtual compliance rule;

Figure 10 is a flow diagram illustrating the growth
regulation of a virtual trading behaviour;

Figure 11 is a flow diagram illustrating the growth
regulation of a "pet" virtual trading behaviour; and

Figure 13 is a flow diagram illustrating the growth
regulation of a "pet" virtual compliance rule.

Example

Referring now to the drawings in detail and
initially to FIG 1 thereof, there is shown schematically
a Trading Irregularity Detection System in which a Real
Trading System 20 comprises a Real Trading Part (RTP) 21
and a Real Compliance Part (RCP) 22. The RTP and RCP may
both in practice comprise a large number of computers,
programs and databases. The Real Compliance Part 22
monitors transactions as they are carried out in the Real
Trading Part 21 with reference to a set of compliance
rules stored in database 19.

A human Compliance Officer (not shown) also
selectively monitors transactions being carried out in
the RTP and attempts to formulate new compliance rules.
When the Compliance Officer formulates a new rule, the
rule is first saved in database 19 as a soft compliance
rule. If the soft compliance rule is broken by a trader
then the Compliance Officer is informed. The Compliance
Officer can then talk to the trader involved. If a soft
compliance rule becomes formally approved by the bank's
management then it is converted in the database 19 into a
hard compliance rule. Thus the database 19 comprises a
mixture of soft compliance rules (which are merely used
to inform the Compliance Officer of potentially non-
compliant transactions) and hard compliance rules which
are used to prevent a transaction from being completed.

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The Real Trading System 20 is logically linked to a
Greenhouse 23 which contains a Virtual Trading Part 24
and a Virtual Compliance Part 25. Virtual Trading
Histories are cultivated using Cultivation means 26 which
builds on aspects of Real Trading Histories from RTP 21
observed and extracted by Observation means 27. Virtual
Trading Histories which give an appreciable apparent
probability of irregularity are identified by
Identification means 28 and then virtual compliance rules
which cover this are developed by regularisation means 29
and added by updating means 30 to the Virtual Compliance
Part 25. Preferably the Real Compliance Part 22 is also
updated with these new rules by updating means 31. It
may be convenient to allow two stages of updating, a
'scanning' stage in which existing real Trading Histories
are scanned by reference to a new rule which has just
been introduced into the Greenhouse 25, and a 'full
updating' stage in which the new rule, having been proven
and examined more thoroughly, is added to the database 19
associated with Real Compliance Part 22. By this time
the new rule may have been generalised and merged with
other rules in a more convenient whole. Of course this is
a logically simplified schematic, and in practice the
functions described here may be implemented on a large
number of computer systems all connected appropriately,
and in particular different aspects of the system
identified schematically as separate components may be
implemented as a set of logical functions on several
computers, possibly logically integrated with other
functions shown here separately.

FIG 2 gives an indication of one possible such
arrangement of functions between computers. A trading
computer 32 implements within itself parts of the Real
Trading System 21a and 22a which perform subsets of the
Real Trading Part 21 and the Real Compliance Part 22
respectively, as well as parts of the Greenhouse (24a,
25a, 26a, 27a, 28a, 29a, 31a) which perform subsets of

the functions 24-31 of Fig 1. Other trading computers
33f, 33g ..33n have a similar internal organisation.
They are connected by a network 34 to each other for
normal trading purposes and to a Greenhouse computer 35
(which may conveniently be a massively parallel
supercomputer) which contains functions 24b-31b which
perform other subsets of the functions 24-31 of Fig 1. A
Compliance computer 36 then implements the principal
parts of the Real Compliance Part 22b together with the
compliance updating functions 31c and 31d. It is worth
remarking that the greenhouse functions of the Trading
Computers 32 and 33f-n can be configured so that they
only consume considerable quantities of computer power
when the traders are absent from their machines. This
allows productive use of the equipment without degrading
the performance while the dealers are using it. Even
more importantly, it ensures that the computer power
available to the Compliance and Greenhouse functions is
essentially equal to the sum of computer power available
to the Traders, plus the assistance of a supercomputer.
The psychological value of having a potential fraudster
realise that he is competing against his own trading
computer plus the combined power of that of all his
colleagues and a central supercomputer is considerable.
Clearly other organisations of the distribution of
functions between computers are possible.

In Table 1 (see Appendix) we give a simplified
illustrative example of a trading system, which will be
used to indicate how the components of the Greenhouse
could be implemented. There are assumed to be two
primitive operations in the system, 40a *Trade* and 40b
Settle so that for example if a (rather inactive) trader
executes two simple transactions and has them settled the
sequence of primitives might look as in the Example 41.
The sequence of transactions 41a-d is an example of what
is referred to herein as a "trading history". There are
two types of State Variable 42a and 42b which model the

size of the 'book' that a Trader holds and the credit
extended to or taken from each counterparty. The
semantics given at 43 explain how the two primitives
modify the state variables, and the initial compliance
constraints given at 44 limit the size of the book and
the credit exposure to any counterparty. In this
simplified illustrative example there is only one trader
and one instrument traded, but the system can clearly be
generalised to an arbitrary set of instruments or
securities by adding an additional parameter to the
"quantity" field to describe which security is being
considered, and to an arbitrary set of traders by having
limits for each trader as well as global limits. It is
important to note that the algorithms for selection of
mates and of populations will need to have some
"geographic" factors to ensure that a level of diversity
and "ecological balance" is maintained, and that enough
crossovers are non-sterile. The practical issues in
managing such a set of constraints in real time over a
distributed database are non-trivial but are common to
all compliance monitoring systems and are not germane to
the present invention.

    Table 2 now shows a simplified example of how the
main Greenhouse functions can be organised. Figure 3 is
a process flow diagram illustrating the functions which
are expressed in Table 2 in pseudocode. The functions
are indicated in Table 2 and Figure 3 using the same
reference numerals. The genetic algorithm illustrated in
Figure 3 generates new virtual trading histories from a
pool of initial trading histories. The pool of initial
trading histories comprises real trading histories 10
which have been extracted from the RTP 21 by observation
means 27, and previously generated virtual trading
histories 11 (i.e. cultivated histories). The following
procedure is repeatedly followed: at 45 the Real
Histories 10 are hybridized with the Cultivated Histories
11 to produce some Hybrids. At 46 randomly chosen pairs

of the Cultivated Histories are 'mated' to produce
'offspring'. Mating and hybridisation are both achieved
by using a 'Crossover' procedure which combines parts of
the two histories in a randomised way. As is the case
with most genetic algorithms, the details of the
Crossover procedure have an important influence on the
performance of the system, but not on the principles. At
47 some random mutations are applied to the population of
Cultivated Histories: again the details of the mutation
algorithm will be discussed later. At 48 the results of
Hybridization, Mating and Mutation are combined into a
single array NewPop, omitting any null elements which may
have arisen (due to unsuccessful attempts at repair
heuristics, see 56 below) - this is done for clarity in
the description and would not necessarily be a separate
algorithmic step. At 49 the Exceptions in NewPop are
identified from which new rules will be generalised.
These Exceptions are identified by means of a scoring
function Score 63. The scoring function is also the
means whereby the selection step in 52 takes place. At
50 the Exceptions are used to generate new rules. It is
sufficient for these illustrative purposes that we assume
that this operation is done offline by the human
Compliance Officer. There are a number of AI-based tools
that can be used to assist him or her in this task,
including some 'genetic' approaches which will be
discussed in more detail later. The key point to note is
that although for simplicity the steps 50 and 51 (where
new Virtual Rules are suggested by the Regulate function
and the Virtual Rules are updated) are shown as part of
the algorithmic loop, they can be done 'offline'. It
will be noted that in this simple example we nevertheless
flag members of the New Population that have been
identified as Exceptions (by setting an attribute
WasException to True in 49a). Exceptions are deleted by
Merge NNX at step 52 before they become candidates to
join the Cultivated Histories. Otherwise there is a

danger that the cultivated population becomes swamped by
Exceptions of one particular kind, especially if the new
rule generalisation is done offline. The fact that we
have disclosed this particular optimisation does not of
course mean that others would not be used in practice:
many practical improvements to the simplified algorithms
presented will immediately suggest themselves to those
skilled in the art, a number of which are discussed in
Michalewicz. In the Selection step at 52 members of the
new Cultivated population are chosen by randomly
selecting from a candidates list (Cands, made by
combining the new population derived at 48 with the
existing cultivated population less any previous
exceptions) in a way that makes the probability of
selection proportionate to the Score. A simplified
outline method is given at 52a, although in practice some
form of sampling without replacement might be used, and
an 'elitist' algorithm would also tend to ensure that the
highest scoring individual was selected in any event.

It is of course possible to consider the more
detailed mechanism discussed above as an example of a
more general procedure in which new members of the
cultivated population are produced by mating and
crossover from a pool of the Real and Cultivated
Histories, relying on chance and the probability
distributions of the selection algorithm to ensure that a
reasonable mix is maintained of real and cultivated
material. This more general procedure is illustrated in
Figure 3A. In this example a pair of initial trading
histories are selected (by "courtship" function 56) from
a pool of initial trading histories, i.e. from the
cultivated histories 11 and the real histories 10. Each
initial trading history has a "state position" in "state
space" which is analogous to geographic location in a
natural breeding environment. For instance a trading
history associated with a Japanese Warrant trader will
have a different state position when compared with a

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trading history associated with a German Equities trader.
The state position may depend on a variety of factors,
the choice of which is an engineering matter. For
example, they could relate to the prevailing market
5   prices of the instruments which were being traded. The
"courtship" function 56 selects pairs of histories x,y in
accordance with a probability distribution function of
the type illustrated at 57, in which d(x,y) is some
suitable distance operator or distance estimate in state
10   space. This does not have to exhibit the classical
properties of distance operators although it may be
desirable for analytical purposes that it should do so.
P(x,y) is the probability of selecting the two histories
x,y. As can be seen, it is less likely (although not
15   impossible) that histories with very different state
positions will be selected. The probability distribution
may also be dependent on whether the histories x,y are
real or cultivated histories. Figure 3B illustrates an
alternative system, and the "breed" function is
20   illustrated in Figure 7.

In Table 2 we show simple examples of Crossover and
Mutate functions. In Table 3 we also illustrate how the
apparent probability of irregularities might be assigned
to a simple system to each history in the array of
25   Histories. The crossover function is illustrated
graphically in Figures 6 and 8. At 53 (Table 2) in the
function XOver which is used to implement Crossover, we
choose random points 70,72 (Figure 6) from the end at
which to cut the Male and Female Histories 74,75 and
30   random lengths (71,73) of each cut. Preferably a random
choice is made which is somewhat biased towards taking
recent histories, for example making the probability of
choosing the kth element proportional to 1/k. As always,
other variants on this distribution can be used without
35   changing the principles. At 54 we then describe the
Crossover function. The Crossover function creates a
Child 76 by extracting a portion 77 of the male history

74, and combining it with portions 78,79 of the female
history 75.   The system applies the XOver procedure and
then checks that the resultant Child 76 meets the virtual
compliance rules. If so, we return Child, but if not we
attempt some repair heuristics.   If these are successful,
ie produce a result of length >0 then we return the
result, otherwise we try again.   (In this simplified
example we are content to have a 'failed' offspring of
length 0 but a practical implementation might use a
global re-try limit and work within this to get some
offspring).   A simplified example of how MakeCompliant
might be structured is given at 59.   Each of the
(Virtual) Rules is assumed to have two methods, a
compliance test **check** which returns **True** if a History
complies, and **False** otherwise, and **RepairHeuristic** which
either returns a compliant history given a non-compliant
one, or a history of length zero.   The nature of the
RepairHeuristic depends on the rule in question, but it
is often enough to delete elements of the History until
the compliance test is met.   For example outlines of
simple RepairHeuristics for CC1 and CC2 are given at 57a
and 57b.   There are several factors which will occur to
those skilled in the art of genetic algorithms relating
to these constraints.   The practical efficiency of a
system will be heavily influenced by the way in which
these are handled.   On the one hand, some of the
constraints may simplify the construction of mutations
because it may be possible to generate mutations which
satisfy the constraints expeditiously.   On the other
hand, some of the constraints may be computationally very
expensive to explore, and it may be appropriate to use
stochastic techniques to reduce the work, and accept that
there is a probability that some of the constraints are
violated.   In particular, it is much less important to
check compliance of histories that are not selected in
the next generation.   Note that, although the general
problem of making an optimal Repair Heuristic is "hard"

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(in the technical sense) the fact that the Male and
Female parent are going to be largely compliant (the only
constraints they can violate are virtual rules that were
added after they were born) should mean that in practice
5   provided suitable "geographic" precautions are taken in
the case of complex systems, Repair Heuristics are likely
to be reasonably successful.) At 58 we give a very simple
mutation function, in which we randomly shuffle some
elements of a history using the Crossover function on
10   itself.

Table 2 shows the remaining elements needed for an
illustrative example, namely an example of how the
Scoring can be done and what form the Histories can take.
The first concept to introduce is the concept of Pinq-
15   ness. This is roughly intended as the Probability that
an Item is Not Quite correct. Pinq-ness is an estimate
of the probability that a trading history merits close
attention from a compliance officer. Each element of the
History has an individual 'intrinsic' Pinq-ness which is
20   shown as an attribute (H[i]-Pinq). At 60 we show in
outline that the Pinq-ness of a History is calculated by
summing the Pinq-ness of each element and then deducting
any corroborations that are found. This summing is an
approximation to the calculation that would be made if
25   each element was statistically independent, ie (1 - the
product of (1 - each individual Pinq-ness)). In our
simplistic example we will consider the Pinq-ness of each
individual transaction as being 1%. But it is important
to note that the Pinq-ness of an individual transaction
30   could in practice be set at different values depending on
the nature of the transaction, counterparty, and trader,
as well as behavioural elements connected with the above.
Examples of factors which may be taken into account when
assigning a Pinq-ness value to a transaction are:
35   a)   a transaction with (say) a well known bank
                might be less Pinq than one with a hitherto un-known
                company;

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b)   some elements of Pinq-ness could be deduced by
means of a statistical analysis of trading patterns,
so that trades which were un-usual, or un-usual for
that Trader, could be assigned a higher degree of
intrinsic Pinq-ness from those that did not have
this property (see Table 6); or

c)   a trader's voice could be recorded and analyzed
for signs of stress - if the trader exhibits signs
of stress then this suggests that the transaction
should be assigned with a high Pinq-ness value.

It is important to note that no transactions should
be considered as having zero Pinq-ness. At 61 we show
how the corroboration value of a History is calculated,
by looking for individual elements that corroborate other
elements. At 62a we show how distance in "state-space"
can be used. The method attractiveness calculates
attractiveness based on a function of the distance
between self and spouse (which is maximised at 1). At 63
we give an example of such a corroboration function:
where we regard receiving a settlement from a given
counterparty of a sum exactly matching the value of a
trade as a strong corroboration. At 62 we indicate that
we are going to take the Score equal to the Pinq-ness in
this example, although there are arguments for weighting
the Pinq-ness by a value at risk and for using some
(continuously increasing) function of Pinq-ness for the
score, to bias the evolution process appropriately. At
64 we show that in this illustrative example a History
Element (class HistElt) is composed of an Entry, a Pinq-
ness, a Corrob attribute (initially 0) and an overall PC
(Pinq-ness Contribution) attribute (which could be
deduced from the Pinq-ness and the Corrob attribute but
which is displayed separately for ease of exposition) and
at 65 we give an example of a History composed of an
array of History Elements, which comes from 41.

Although the idea of intrinsic Pinq-ness is
appropriate in this illustrative example, it the overall

Pinq-ness does not have to be calculated in this way.
Other approaches to estimating Pinq-ness would include
ones based on a statistical assessment of the overall
pattern of the history, possibly in relation to its
environment and possibly in relation to the positions of
the history in Phase Space. Alternatively, a stochastic
approach to assigning pinq-ness could be taken, with
simple programs "firing" pinq-ness at histories as they
happen to detect untoward features. Many other
refinements will suggest themselves to those skilled in
the art.

     As will be well-known to those skilled in the art,
the choice of the methods of defining and calculating
Pinq-ness will be sensitive both for the practical
efficiency of the system and for the types of fraudulent
or questionable behaviour that it can detect. In the
following simple example we offer a relatively simple
scheme, but issues and refinements are readily added.
For example, statistical approaches to assessing
Pinq-ness can be made more sophisticated, and various
aspects of Complacence Officer behaviour can be observed
and learned (either by Genetic Algorithm means as
discussed below, or by other well-known means such as
Expert Systems or Neural Networks). To reduce the
computational workload of calculating Pinq-ness it may
also be appropriate for some of the algorithms for
adjusting Pinq-ness to be applied on a stochastic basis,
periodically examining selected members of the breeding
population and adjusting the Pinq-ness estimates up or
down. This could be done by several parallel routines,
selected if necessary according to the extent to which
applying these routines was making significant
differences to the estimated Pinq-ness.

     Depending on the level of computational resources
available, various measures will be necessary or
desirable to limit the amount of "search space" explored
by the system. For example, there is only limited

20

economic value in detecting and preventing fraudulent
behaviour that is remote from the behaviour actually
indulged in by any traders or other employees of the Bank
in question. Thus the key practical question becomes:

5   what steps could be taken in the next n days by a Trader
which might expose the Bank to risk? Consequently, it
would be possible to restrict the way in which the mating
and mutation functions are applied to limit consideration
to short-term continuations of existing trading

10   histories. Such limits might be applied stochastically,
so that there was no absolute assurance that a fraud
requiring n+1 days to execute would not be detected.
       Clearly the Pinq-ness of a trading history might
also depend on the market context and general trading

15   conditions. For example relatively large differences
between the prices at which securities are bought and
sold are less suspicious if the markets are fluctuating
considerably than if they are largely stable. Practical
implementations might encode such contextual information

20   into the "trading histories". One possibility is for
relevant information about trading conditions to be
encoded as "recitals" rather like the "WHEREAS" clauses
in legal documents. Distinguishing the relevant
background information is a non-trivial engineering

25   problem, although for any particular trade there are only
a limited number of markets whose conditions are likely
to be significant. One possibility is for the system to
learn which are relevant market conditions from the
behaviour of experienced Compliance Officers by observing

30   the checks that they make.
       Table 3 now shows an illustrative example of
applying the algorithms described to some simple data.
We assume for simplicity that there is only one trader,
so only one Real History which is that shown at 65. We

35   will assume that there are 2 Cultivated Histories, and we
will initialise them by random Crossovers from the Real
History, yielding C1 and C2 illustrated at 81 and 82. We

then apply step 45 and Hybridise R1 with C2 (chosen at random). C3 at 83 is obtained, after the Repair Heuristic has removed an additional "Trade(Fred, 10L, $100)" which would have violated CC2 (at 44b). Applying

5   Step 46 Mating we Crossover C1 and C2 to get C4 at 84, and a mutation as Step 47 to give C5 at 85. For the Identify step 49 we will suppose for illustrative purposes that the IdentifyThreshold in 49a is 4%, in which case C4 at 84 has a Pinq-ness over the threshold.

10   This causes its wasException attribute to be set to True, and it is passed to the Compliance Officer to determine whether a new Virtual Rule should be added. He/she may decide that a new rule should be added to the effect that trades must be settled within a certain number of days

15   (again, in practice such a rule would almost certainly be in place, but the point of this very simplified example is to give a simple illustration of the principles. Genetic algorithms are well known for being capable of scaling up relatively well and cope with very complex

20   situations }. For illustrative purposes we will assume that a New Virtual Rule is added at 86. As indicated in the discussion of Fig 1, this new rule could then be used to scan all the Real trades to make sure that none were suspicious, and any violators would be brought to the

25   attention of compliance. Note that this means that another trader who might have been doing un-confirmed trades can be caught as a result of analysing his/her perfectly blameless colleague. Finally the Selection step 52 is performed whereby 2 of the 5 cultivated

30   histories C1, C2, C3, C4 and C5 are chosen at random for survival, with a probability proportional to their Score (possibly with some elitist adjustments). We assume that C2 and C4 survive.

     At 87 we give the effect of the next hybridization,
35   mating and mutation steps, using a condensed notation in which for example Trade (Fred, 10, 100) becomes T10F100, with an underline for the elements that have a non-zero

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corroboration. R1, C2 and C4 are given in this condensed
notation for comparison. All the elements in the
cultivated histories appear in R1, since they are all
derived genetically from it and *in this simplified*
5   *example* none of the genetic operators introduce new
elements. This would not necessarily be the case in a
real system, which might have several other genetic
operators.

Table 4 illustrates one way in which statistical
10   properties of the traders' behaviour could be used to
assign different initial Pinq-ness to different base
actions. 91 shows a rolling cumulative tally is kept for
each Trader, for each Team and for the Group as a whole
of the probability (based on observed behaviour) of a
15   deal with each Counterparty and of the mean and standard
deviations of the sizes of the deal. Based on this
information, the Pinq-ness of a transaction can be set
using suitable heuristics: for example as illustrated at
92 the Pinq-ness could be the mean of the Trader-
20   Pinqness, the Team-Pinqness and the Group-Pinqness and
each of these, as suggested at 93, could be calculated by
adding the intrinsic Pinq-ness of the Trader (or Team or
Group, which could be based on the number of compliance
hits previously encountered - and would preferably be
25   algorithmic to avoid people getting excited about
'subjective' judgements) and of the Counterparty and
dividing by the probability that the trader deals with
the Counterparty and the probability of a deal of that
size, based for example on the observed mean and standard
30   deviation of previous deals with that Counterparty.
These Pinq-nesses could also be adjusted based on
statistically-derived curves of typical trader behaviour.
Such statistics would be interesting to compliance in any
case.

35   FIG 4 shows a natural extension of the evolutionary
aspects of the Greenhouse, in which the compliance rules
developed by regularisation means 29 are represented by

Elephants.   Each Elephant 94a-94g is a potential
Compliance Rule and new Elephants are bred (by suitable
crossover and mutation and other specialist algorithms,
along the lines described above in Figure 3,3A and 3B) at
random using Breeding Means 95 and growth regulating
means 96, whereby they are "fed" by Pinq Cultivated
Histories identified by step 49 (with the "food" being
distributed to the Elephants that would preferentially
identify the History), and to a lesser extent by Repair
Heuristics when they are applied.   The Growth Regulating
Means 96 also preferably has a source of "poison" so that
Elephants are not bred which simply munch good histories,
and for this purpose the Real Histories can be used,
providing that low doses of the poison are not fatal (so
that if an Elephant is fed a Real History that happens to
contain an irregularity this will not be fatal to the
Elephant), and this is indicated by the link at 97
between function 27 and function 96.   One general
approach to the evolution and breeding of such Elephants
is discussed in Michaelewicz Chapter 12 and is a well-
studied topic in the literature.   One possibility would
be for the Elephant's decision method on how appetizing a
History was to be encoded as a Java Method associated
with the Elephant, and to apply genetic operations along
the lines of those contained in Michaelewicz to the Java
code of the Method.   The "feeding" and "poisoning"
functions contribute to a "weight" parameter.   Once an
Elephant has a "weight" factor above a certain threshold,
then it would be inspected by the Compliance Officer and
released into the "wild" to monitor the Real Trading
Environment   - ie. in the example of Figure 4 the largest
compliance rule 94g would be saved in VCP 25 and in RCP
22 as a soft compliance rule.   The use of genetically
developed "Elephants" is an elegant approach to the issue
of devising new compliance rules, but by no means the
only one that would be suitable, and in any case it is
probable that manual supervision would be required.

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Careful attention would be given in the design of any
practical automated system to ensure that the new Virtual
compliance rules did cover all highly Pinq cases
identified, with auditing and security measures to ensure
that a computer-literate rogue trader was not in some way
inhibiting the development of Rules (by whatever means)
that would detect his/her preferred irregularity.

The present invention relates to a compliance
system. However the principles of the invention could
also be implemented in other systems in which the
selection means selects virtual trading histories which
satisfy some other criteria. For instance the selection
means may select better legal money-making virtual
trading histories which can then be reviewed to determine
new trading strategies for use in the real trading
system. An example of this is discussed below with
reference to Figure 5.

In the most sophisticated embodiment of the present
invention, the greenhouse develops both compliance rules
94a-94g (Elephants) and trading behaviours 97a-97f
(Tigers). Similar genetic operators can be used for the
crossover and mutation of these "programs" but the
fitness criteria used for selection are different.
Referring to Figure 9, the virtual compliance rules 94
(ie. Elephants) review trading histories at 100. If the
history is compliant (step 101) according to the virtual
compliance rule 94 then if the trading history has a high
Pinq-ness value (step 102) then the Elephant is "fed"
(step 103). Otherwise the Elephant 94 is "poisoned"
(step 104). If the history is non-compliant (step 101)
then if the trading history has a high Pinq-ness value
(step 105) then the Elephant is "fed" (step 106).
Otherwise the Elephant 94 is "poisoned" (step 107).
Poisoning is slow, so that one or two doses weaken, but
do not kill.

Tigers on the other hand are allowed to trade in the
VTP 24, either trading with each other or preferably

trading with representations of counterparties 100a-100d
(illustratively represented as Buffalo. These might be
derived as genetic algorithms or by other means).
Referring to Figure 10, the virtual trading behaviours
(ie. tigers 97) perform virtual transactions 110 on VTP
24. If the virtual transaction makes money (step 111)
then the tiger is "fed" at 112, otherwise it is
"poisoned" at 113. If the virtual transaction is
compliant (step 112) then the tiger is "fed" at 112,
otherwise it is "poisoned" at 113. The degree of
poisoning is dependent on the weight of the compliance
rule which has been broken.

The tigers 97 can also explicitly learn from
observation of Traders' actions as illustrated in Figure
11. A real trader initiates a transaction at 120. One
of the tigers 97 then predicts at 121 how the real trader
will complete the transaction. If the tiger 97 predicts
the action of the trader correctly (step 122) then the
tiger 97 is "fed" at 123, otherwise the tiger 97 is
"poisoned" at 124. The tiger 97 may also be "fed" by
attempting to predict other actions of a real trader.
Before making a transaction, a real trader may carry out
a number of checks. For instance he could check
prevailing prices in other markets, he could check the
creditworthiness of the company to be traded with, or he
could review news reports from the country of the company
to be traded with.

In this way, ie. by comparing the behaviour embodied
by the "pet tiger" with the actions of a real trader, a
set of "pet Tigers" 97 is generated which are essentially
genetic algorithmic representations of the trader's
behaviour. The "pet Tigers" are then hybridised with the
Tigers in the Greenhouse to produce further genetic
input, the basic structure of the algorithms used being
of course similar to that in Figure 3. Tigers could also
be used to generate Pinq trading histories for
consideration in developing new compliance rules.

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A simple "Tiger" might be implemented as shown at
151.

In this simple example a Tiger has one "method":
Accept Offer. A simplified example of how Accept Offer
5   might be implemented is given a 152.

This very simple Tiger has two price thresholds, buy
& sell, and will trade if offered a quantity it can
legally hold at a price below buy Threshold or if asked
for a quantity it has a price above its sellThreshold.

10   In practice Tigers would of course be considerably
more complicated, and might involve neural networks or
other advanced techniques. Different species of Tiger
might co-exist, with the Courtship function making it
unlikely that the system would try to mate a Neural Net
15   Tiger with a simple decision rule Tiger (but it would not
necessarily have to be impossible).

Buffalo are bred in a similar way, preferably with a
cluster of pet buffalo assigned to each counterparty (fed
when they correctly mirror the actions of the
20   counterparty, poisoned when they do not) and with the
cultivated buffalo bred in the same way and trading with
the cultivated tigers. In principle they could be
subject to the same compliance rules (Elephants) as the
Tigers, although in practice it might be wiser to have
25   the buffalo only trampled by real Elephants whereas the
Tigers might be trampled by cultivated Elephants as well.

It will be evident to those skilled in the art that
it is possible for the Trading Histories of the Tigers to
be used as a source of cultivated Histories as well. It
30   would be possible, although may be not desirable, for the
genetic aspects of the greenhouse in cultivating
histories to be superseded by the zoological functions,
so that instead of breeding histories explicitly we just
observed the behaviour of the real Traders and the pet
35   and cultivated Tigers and used these histories alone to
find Pinq-ness.

27

By analogy with the concept of "pet Tigers" illustrated in Figure 11 - the compliance rules 94 (ie. elephants) may be bred to become genetic algorithmic representations of the behaviour of the human Compliance

5   Officer. At step 130 the Compliance Officer reviews a set of transactions being performed in the RTP 21. The compliance rules 94 then predict at 131 which particular transactions will be reviewed further by the Compliance Officer. If the prediction is correct (step 132) then

10   the "pet elephant" 94 is fed at 133 - or otherwise "poisoned" at 134.

The "pet elephant" 94 can also review at 135 transactions in the RTP 21. If the "pet elephant" 94 finds a non-compliant then the Compliance Officer is

15   notified at 136. If the transactions are of interest (step 137), then the Compliance Officer causes the "pet elephant" to be "fed" at 133 - or otherwise "poisoned" at 134.

The choice of thresholds for reporting behaviours

20   with high apparent pinq-ness raises the normal engineering issues about false alarms and Type-1 and Type-2 errors. One possibility for dealing with this is to have the Pet Elephants or some other "expert system" or "Neural Net" watch the way in which Compliance

25   Officers deal with the alarms raised, and use this information to make better judgements about whether a behaviour of a given threshold pinq-ness is in fact sufficiently serious to justify reporting, or to use such systems to classify alarms appropriately.

APPENDIX

Table 1 - Simplified Illustrative Trading System

40 Primitives

40a   Trade (c:counterparty, q:quantity, p:price)

        input by the Dealer

40b   Settle (c:counterparty, v:price)

        input by the Back Office

41 Example

41a   W1[1] Trade (Fred, 10L, 100)

        buy 10 lots from Fred at $100

41b   W1[2] Trade (Geoff, -9L, 101)

        sell 9 lots to Geoff at $101.

41c   W1[3] Settle (Fred, $1,000)

        pay Fred 10 x $100

41d   W1[4] Settle (Geoff, -$909)

        get $909 from Geoff.

42 State Variables

42a   Book: quantity   -- The number of lots held at any one time

42b   Balance (c:counterparty):price   -- The total amount owed to / owing from c.

43 Semantics

43a   Trade (c,q,p) ->   Balance(c) := Balance(c) + q * p; Book := Book + q

43b   Settle (c, v)   ->   Balance (c) := Balance (c) - v

44 Initial Compliance Constraints

44a   CC1: abs(Book) < = MaxBook   -- a constant

44b   CC2:   abs (Balance(c)) < = CounterpartyLimit   -- another constant.

For simplicity MaxBook = 20 and CounterpartyLimit = $2000.

30

Table 2 - PseudoCode for Main Greenhouse Function

```
mVersion = 'NB 13 June 98 v0.51'
/*************************************************/
::class histories subclass array
/*NB these program fragments are illustrative and are given
as syntactically correct pseudocode which would guide someone
skilled in the art in constructing a practical implementation.
They are not represented as perfect */
/* constants assigned to values with 'say' are illustrative */
/* and would often in practice have much larger values      */
/***************************************************/
/*main loop from Patent                                    */
/* cHists-mainloop(rHists)                                 */
/* does one generation of cultivation     */
::method mainloop; use arg rHists
  cHists = self                        /*for clarity*/
  nOffSpring = 10; nMutants = 3     /*say*/
  nNewCH = 6; nHybrids= 9              /*say*/
/*45*/ hybrids = rHists-hybridise(cHists, nHybrids)
/*46*/ offspring = cHists-mate(nOffSpring)
/*47*/ mutants = cHists-mutateStep(nMutants)
/*48*/ newPop = hybrids-mergeNNX(offspring-mergeNNX(mutants))
/*49*/ newExceptions = newPop-identifyExcep
/*50*/ ruleCands = newExceptions-regulate
/*51*/ .local-CRules-updateRules(ruleCands)
/*52*/ Cands = cHists-mergeNNX(newPop)
       newCHists= Cands-select(nNewCH)
  return newCHists
/* Note - you would probably in practice make a distinction */
/* between existing cHists and newPop                        */
/***************************************************/


/*45a rH-hybridise(cH,n)                              */
/*makes n hybrids between elements of rH  & cH        */
::method hybridise; use arg cH, n
  hybrids = .histories-new(n)
  do i = 1 to n
    me = self[random(1,self-ln)]    /*select me*/
    spouse = cH-findMate(me)        /*find spouse*/
    hybrids[i] = me-crossOver(spouse)
  end i
  say '**HYBRIDS are'; hybrids-sprint        /*debug*/
  return hybrids


/*45b spice-findMate(me) finds a spouse for me        */
```

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```
/*This v simple version would be replaced by something        */
/*more sophisticated, eg along lines of 45c              */
::method findMate; use arg elt
  spouse = self[random(1,self-ln)]
  return spouse


/*45c spice-court(me)    finds a spouse for me          */
/* using an attractiveness measure & threshold          */
::method court; use arg elt
  nTry = 5  /*say*/
  spouse = .nil
  BestSoFar = .nil; aBestSoFar = 0
  do i = 1 to nTry while(spouse=.nil)
    Try = spice[random(1,spice-ln)] /*see note*/
    aTry = me-attractiveness(Try)
    if aTry > me-aThreshold then spouse = Try
    else if aTry > aBestSoFar then do
      BestSoFar = Try; aBestSoFar = aTry
    end /*if*/
  end i
  if spouse = .nil then spouse = BestSoFar
  return spouse
/*Note: with large spice sets you could use cleverer  */
/* ways of trying to find a more attractive spouse if */
/* the properties of attractiveness were known well    */
/* enough to allow eg crude hill-climbing methods      */
/* You could also eg give each history a 'tribe' and   */
/* look in the same tribe for spice most of the time   */


/*46a parentSet-mate(n)                                 */
/*returns n children by mating random parents          */
::method mate; use arg n;
  off = .histories-new(n)
  do i = 1 to n
    me = self[random(1,self-ln)]      /*choose me*/
    spouse = self-findMate(me)        /*find mate*/
    off[i] = me-crossOver(spouse)
  end i
  return off


/*47a parents-mutateStep(n)                             */
/*returns n mutants from random parents                 */
::method mutateStep; use arg nMut
  muts = .histories-new(1)
  do i = 1 to nMut
```

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```
      muts[i] = self[random(1, self-ln)]-mutate
   end; return muts


/*48a left-mergeNNX(right)                                    */
/* returns left & right merged less nulls & Exceptions */
::method mergeNNX; use arg right
   res = .histories-new(1)
   jRes=1
   do i = 1 to self-ln
     if self[i]-ln>0 then do
       if self[i]-wasException = 0 then do
         res[jRes] = self[i]; jRes=jRes+1
       end /*if*/
   end; end i
   do i = 1 to right-ln
     if right[i]-ln>0 then do
       if right[i]-wasException = 0 then do
         res[jRes] = right[i]; jRes=jRes+1
       end /*if*/
   end; end i
   return res


/*49a pop-indentifyExcep              */
/*returns the exceptions in pop       */
::method identifyExcep; exceptions = .histories-new(1)
/*  trace a; say self-ln      debug*/
   jEx = 0; Threshold = 0.1 /*say*/
   do i =1 to self-ln
     if self[i]-pinq > Threshold then do
       jEx = jEx + 1; exceptions[jEx]=self[i]
       self[i]-wasException = true
   end; end i
   return exceptions


/*52a pop-select(n)                   */
/*selects n elements in pop with p - score              */
::method select; use arg nFind
   selected = .histories-new(1)
   totScore=0.0; cumulativeScore=.array-new(self-ln)
   do i = 1 to self-ln
     totScore = totScore + self[i]-score
     cumulativeScore[i] = totScore
   end i
   do j = 1 to nFind
     rScore = random(0,trunc(totScore*10000))/10000
```

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```
     rN=1
     do k = 1 while rScore >= cumulativeScore[k]
       rN = k
     end k
     selected[j]=self[rN]
   end j
   return selected


/*****************************************************/
::Class history subclass array
/*53 m-XOver(f)                                        */
/* returns a random crossover between m and f          */
::method xOver; use arg  f;
   cutM = random(0,self-ln-1)
   cutF = random(0,f-ln)
   cutLM = random(0, self-ln - cutM)
   cutLF = random(0, f-ln - cutF)
   return self-cutting(f,cutM,cutF,cutLM,cutLF)
 /* this (sub)method shown separately for clarity      */
 ::method cutting; use arg f, cutM, cutF, cutLM, cutLF
   child = .history-new; child-initialise(0)
   do i = 1 to cutF
     child[i]=f[i]-copy
   end i /*ffff*/
   do i = CutF + 1 to CutF + cutLM
     child[i] = self[cutM + i - CutF]-copy
   end i /*ffffmmm*/
   do i = cutF+cutLM+1 to f-ln + CutLM -CutLF
     child[i] = f[i -cutLM +cutLF]-copy
   end i /*ffffmmmff*/
   return child


/*54 m-Crossover(f)                                    */
/*returns a random compliant crossover or null  */
::method Crossover; use arg f
   child=.history-new; child-initialise(0)
   maxRepairAttempts =10 /* say */
   do i = 1 to maxRepairAttempts while child-ln =0
     child = (self-xOver(f))-makeCompliant
   end i
   return child


/*59 h-makeCompliant                                   */
/*returns a compliant version of h or null       */
::method makeCompliant
```

34

```
  v = self          /*initially*/
  do iRule = 1 to .local-CRules-ln
    if (.local-CRules-Check(iRule,v)) then
        nop          /*fine*/
    else v = .local-CRules-repairHeursitic(iRule,v)
  end iRule
  return v


/*58 h-mutate                                            */
/*does a mutation - for simplicity by self-mate */
::method mutate
  return self-crossover(self)


/*60 h-ping                                         */
/*gives the pinq-ness of h                          */
::method pinq; x =0.0
  sL = self-ln
  do j = 1 to sL          /*initialise*/
    self[j]-Corrob = -1
    self[j]-PC = self[j]-pinq
  end j
  do i = 2 to sL                  /*no self-corroboration */
    self-corrobCheck(i)           /*do previous elts help */
  end i
  do j = 1 to sL  /*sum pinqness contributions*/
    x = x + self[j]-PC
  end j
  /*say 'pinqness =' x 'of history ln' self-ln  debug*/
  /*self-mprint                          debug*/
  return x


/*61 corrobCheck(i)                                 */
/*does a corroboration check on ith elt of self */
::method corrobCheck; use arg i
  cVal = 0.0                       /*initialise cVal */
  do k = 1 to i-1 while(cVal= 0.0)
    if ((self[k]-corrob < 1) & (self[i]-corrob<1)) then do
      cVal = self[k]-corrobValue(self[i])
      if cVal > 0.0 then do   /*use it */
        self[i]-Corrob = k
        self[k]-Corrob = i
        self[i]-PC = self[i]-pinq - cVal/2
        self[k]-PC = self[k]-pinq - cVal/2
      end /*if*/
    end /*if*/
```

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```
  end k
  return CVal


/*62 h-score                           */
/* in this example, simply the pinqness  */
/* a method for history so moved up     */
::method score
  return self-pinq


/*62a me-attractiveness(spouse)            */
/*simple example using a function of distance  */
/*based on a distance measure in state space  */
::method attractiveness; use arg spouse
  mDist = self-distance(spouse)
  aMeasure = mDist * exp(-mDist)
  return aMeasure



/***************************************************************/
::class histElt


/*63 he1-CorrobValue(he2)              */
/* = how well he1 corroborates he2     */
::method corrobValue; use arg he2
    cV = 0.0                      /*initialise */
  if self-counterparty = he2-counterparty then do
  select
    when self-operand = 'Settle' then
      if he2-operand = 'Trade' then
        if self-val = he2-quantity * he2-price then
            cV = self-PC + he2-PC -self-PC*he2-PC
    when self-operand = 'Trade' then
     if he2-operand = 'Settle' then
       if he2-val = self-quantity * self-price then
          cV = self-PC + he2-PC -self-PC*he2-PC
    end /*select*/
  end /*if*/
  return cV


  /*64 some other methods for class HistElt  */
  ::method t attribute    /*string - transaction */
  ::method pinq attribute /*intrinsic pinqness    */
  ::method PC attribute   /*pinqness contribution*/
  ::method Corrob attribute /*points to corroboration*/
```

36

```
/****************************************************/
::class TigerSet subclass animalSet


/*150 method tigerBreed                          */
/* newCultTs = cultTs-tigerBreed(petTs, elephs, buffs)*/
::method tigerBreed
  use arg petTs,elephs,buffss
  nMatedTs = 5; nNewCultTs = 10              /*say*/
  petTs-breedAndFeed
  hybridTs = petTs-hybridise(self)
  matedTs = self-mate(nMatedTs)
  theseTs = self-append(hybridTs-append(matedTs))
  theseTs-tradeEvaluate(buffs)
  theseTs-trample(elephs)
  newCultTs = theseTs-select(nNewCultTs)
  return newCultTs


/****************************************************/
::class tiger subClass animal


/*151 attributes for simple tiger         */
::method profit attribute
::method capitalEmployed attribute
::method book attribute
::method maxBook attribute
::method buyThreshold attribute
::method sellThreshold attribute


/*152  simple acceptOffer method           */
/* tiger-acceptOffer(p,q)      would I accept q at p   */
::method acceptOffer
  use arg p,q
  ifAccept = 0     /*unless decided otherwise    */
  select
  when q>0 then
    if p<self-buyThreshold then
      if q + self-book < self-maxBook then
        ifAccept = 1
  when q<0 then
    if -q <= self-book then
      if p> self-sellThreshold then
        ifAccept = 1
  end /*select*/
  return ifAccept
```

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```
/*****************************************************/
/*153 method petTigerBreed to be added here      */
/*****************************************************/
/*153 petTs- petTigerBreed(trader)               */
/*breeds pet Tigers to track trader              */
::method petTigerBreed
  use arg trader
  nOff = 10; nMut = 5; nPets = 10     /*say*/
  offspring = self-mate(nOff)         /*a*/
  mutants = self-mutateStep(nMut)     /*b*/
  cands = self-merge(offspring-merge(mutants))
  cands-ptScore(trader)               /*c*/
  newPets= Cands-select(nPets)
/*newPets-ptScore(trader)                -c*/
  return newPets
/*Notes                                          */
/*a: initial fitness of child could be avg       */
/*   fitness of parents                          */
/*b: initial fitness of mutant could be random   */
/*   adjutment to that of its parent             */
/*c: alternative - a bit less accurate but saves*/
/*   some compute time                           */
/*other breeding operations broadly analagous    */
/*to those given above - minus pinqness          */
/*very un-fit tigers might be culled             */
/*pet elephants could breed similarly            */


/*****************************************************/
/*153a Tigers-ptScore(trader)               */
/*scores pets for how they match trader actions */
/*those whose next actions are highly compatible*/
/*with the trader's next action get fitter    */
/*and vice versa                            */
::method ptScore
  use arg trader
  tAction = trader-nextAction
  do i = 1 to self-ln
    pAction = self[i]-nextAction
    score = pAction-compatibilityScore(tAction)
    self[i]-fitness = self[i]-fitness + score
  end i
  return

65    An example History (W1) (derived from 41)
```

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Element No	Entry	Pinq	Corrobs	PC
1	"Trade (Fred, 10L, 100)"	1%	3	0.01%
2	"Trade (Geoff, -9L, 101)"	1%	4	0.01%
3	"Settle (Fred, $1,000)"	1%	1	0.01%
4	"Settle (Geoff, - $909)"	1%	2	0.01%

Pinq(W1) = 4% - 2 x (2% - 0.01%) = 0.02%

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Table 3 Simple Worked Illustrative Example

80Assumed 'Real' History including the new elements added each step

Index	Entry	Pinq	Corrob	PC	Comment
R1[1]	Trade (Fred, 10L, 100)	1%	3	.005%	*10 Lots from Fred at 100*
R1[2]	Trade (Geoff, -9L, 101)	1%	4	.005%	*9 Lots to Geoff at 101*
R1[3]	Settle (Fred, $1,000)	1%	1	.005%	*Pay Fred $1000*
R1[4]	Settle (Geoff, -$909)	1%	2	.005%	*Get $909 from Geoff*
R1[5]	Trade (Fred, 4, 102)	1%	6	.005%	*4 lots from Fred at 102*
R1[6]	Settle (Fred, $408)	1%	5	.005%	*Pay Fred $408*

81Example Cultivated History C1

Index	Entry	Pinq	Corrob	PC	Comment
C1[1]	Trade (Fred, 10, 100)	1%	3	.005 %	*from R1[1]*
C1[2]	Trade (Geoff, -9, 101)	1%	5	.005 %	*from R1[2]*
C1[3]	Settle (Fred, $1,000)	1%	1	.005 %	*from R1[3]*
C1[4]	Settle (Fred, $1,000)	1%		1%	*from R1[3] - inserted*
C1[5]	Settle (Geoff, -$909)	1%	2	.005 %	*from R1[4]*

1.02% Pinq

82Example Cultivated History C2

Index	Entry	Pinq	Corrob	PC	Comment
C2[1]	Trade (Fred, 10, 100)	1%	3	.005%	*from R1[1]*
C2[2]	Trade (Geoff, -9, 101)	1%	0	.005%	*from R1[2]*
C2[3]	Settle (Fred, $1,000)	1%	0	.005%	*from R1[3]*
C2[4]	Trade (Fred, 10, 100)	1%	6	1%	*inserted R1[1]*
C2[5]	Trade (Geoff, -9, 101)	1%	0	.005%	*inserted R1[2]*
C2[6]	Settle (Fred, $1,000)	1%	0	1%	*from R1[4]*

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2.02% Pinq

83.Example Cultivated History C3, obtained by Hybridization Crossover (R1, C2)

C3[1]	Trade (Fred, 10, 100)	1%	6	.005%	*from C2[1]*
C3[2]	Trade (Geoff, -9, 101)	1%	3	.005%	*from C2[2]*
C3[3]	Settle (Geoff, -$909)	1%	1	.005%	*R1[4]*
C3[4]	Trade (Fred, 4, 102)	1%	0	1%	*from R1[5]*
	Trade (Fred, 10, 100)				*from C2[4] - eliminated.*
C3[5]	Trade (Geoff, -9, 101)	1%	0	1%	*from C2[5]*
C3[6]	Settle (Fred, $1,000)	1%	2	.005%	*from C2[6]*

2.02% Pinq

84.Example of Cultivated Offspring from Crossover(C2, C1)

C4[1]	Trade (Fred, 10, 100)	1%	3	.005%	*from C1[1]*
C4[2]	Trade (Geoff, -9, 101)	1%	0	1%	*from C1[2]*
C4[3]	Settle (Fred, $1000)	1%	1	.005%	*from C1[3]*
C4[4]	Settle (Fred, $1000)	1%	0	1%	*from C1[4]*
C4[5]	Trade (Fred, 4, 102)	1%	0	1%	*from C2[4]*
C4[6]	Trade (Geoff, -9, 101)	1%	0	1%	*from C2[5]*

4.01% Pinq

85.Example of Mutated offspring C5 from Crossover (C1, C1)

C5[1]	Trade (Fred, 10, 100)	1%	3	.005%	*from C1[1]*
C5[2]	Trade (Geoff, -9, 101)	1%	4	.005%	*from C1[2]*
C5[3]	Settle (Fred, $1,000)	1%	1	.005%	*from C1[3]*
C5[4]	Settle (Geoff, -$909)	1%	2	.005%	*from C1[5]*
C5[5]	Settle (Fred, $1,000)	1%	0	1%	*from C1[4]*
C5[6]	Settle (Geoff, -$909)	1%	0	1%	*from C1[5]*

2.02% Pinq

86. New Virtual Rule added as a result of steps 50 and 51

CC3:Any trade must be settled within 5 steps of it being made.

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1.Effect of next round, in condensed notation (with R1, C2 & C4 given for

comparison)

87a R1:T10f100,T-9g101,Sf1000,Sg-909,T4f102,Sf408

87b C2:T10f100,T-9g101,Sf1000,T10f100,T-9g101,Sf1000

87c C4:T10f100,T-9g101,Sf1000,Sf1000,T4f102,T-9g101

87d C6:T10f100,T-9g101,Sf1000,Sf1000,T10f100,T-9g101,Sf1000

87c C7:T10f100,T-9g101,T-9g101,T-9g101

87f C8:T10f100,T-9g101,Sf1000,Sf408,Sg-909,T4f102,Sf408

87g C9:T10f100,Sf1000Sg-909,T4f102,Sf1000,T-9g101,T9g101,Sf100,T-9g101

88New Virtual Compliance Rule added

CC4No pre-payments are allowed.

4?

Table 4 - Statistical Adaptive Assignment of Pinq-ness

91 *Rolling Cumulative Tally of counterparties -*

Counterparty	p	Trader (B) Mean	Std	p	Team (X) Mean	St	p	Group (Y) Mean	Std
Fred	10%	1000	200	10%	1000	200	10%	1000	200
George	5%	500	200	20%	200	50	30%	200	50
Henry	1%	700	100	20%	400	100	15%	400	100
Imogen	25%	1000	300	5%	400	100	1%	300	50

Note in this illustrative example that the dealing patterns of Fred are
very consistent, but that the Trader does many more transactions with
Imogen and they are substantially bigger than the average done by his
team or the Group. This may be entirely fine, but understandably
raises the Pinq-ness of such transactions.

92　Illustrative example of Pinq-ness formula

```
    Pinq(T:Trader, C:Counterparty, V:Value)=
        (BPinq(T,C,V)+BPinq(Team(T),(C,V)+BPinq(Group(T),C,V)/3
93  BPinq (X,C,V)=  for X being a Trader, Team or Group
            IntrinsicPinq(X)+IntrinsicPinq(C)
        ----------------------------------------
        p(X,C)NormalProb (V,Mean(X,C),Std(X,C))
```

where

IntrinsicPinq is the Intrinsic Pinqness associated with X or C

p(X,C) is the observed probability of X dealing with C

Mean(X,C) is the "Mean" column for X of C

Std (X,C) is the "Standard Deviation" column for X for C

NormalProb (v,m,s) is the probability that v will be drawn from

a normal distribution of mean m and std s

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CLAIMS

1. A system for generating compliance rules, the system comprising

a compliance rule memory for storing compliance rules;

5   generation means for generating virtual trading histories, virtual trading behaviours and/or virtual compliance rules; selection means for selecting virtual trading histories, virtual trading behaviours and/or virtual compliance rules; and

10   updating means for storing virtual compliance rules in the compliance rule memory, wherein the virtual compliance rules have been developed with reference to the selected virtual trading histories, virtual trading behaviours and/or virtual compliance rules.

15   2. A system according to claim 1 further comprising a compliance monitor which monitors transactions carried out on a real trading system with reference to the compliance rules stored in the compliance rule memory.

3. A system according to any of the preceding claims

20   further comprising extraction means for extracting real trading histories, real trading behaviours and/or real compliance rules from the real trading system and inputting the extracted trading histories to the generation means.

4. A system according to any of the preceding claims

25   wherein the generation means generates the virtual trading histories, virtual trading behaviours and/or virtual compliance rules by modifying initial trading histories, trading behaviours and/or compliance rules in accordance with a genetic algorithm.

30   5. A system according to any of the preceding claims further comprising regularisation means for determining the virtual compliance rules from the selected virtual trading histories or behaviours.

6. A system according to any of the preceding claims

35   wherein the selection means comprises

scoring means for estimating an apparent level of irregularity of the virtual trading histories; and

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identification means for selecting virtual trading histories on the basis of their estimated apparent level of irregularity.

7. A system according to claim 6 wherein the virtual trading histories each comprise a sequence of virtual transactions, and wherein the scoring means assigns an individual apparent level of irregularity to each virtual transaction, assigns a level of corroboration to some of the virtual transactions, and estimates the apparent level of irregularity of the virtual trading history in accordance with the individual apparent levels of irregularity and the levels of corroboration.

8. A system according to claim 6 or 7 wherein the virtual trading histories each comprise a sequence of virtual transactions, and wherein the scoring means assigns an individual level of irregularity to each virtual transaction by reference to statistical criteria based on the real trading histories carried out on the real trading system.

9. A system according to any of the preceding claims wherein the generation means is adapted to check virtual dealing histories against one or more current compliance rules stored in the compliance rule memory.

10. A trading system comprising

a real trading system; and

a compliance monitoring system according to any of the preceding claims.

11. A trading system according to claim 10 wherein the real trading system comprises a plurality of trading computers connected to a common network, and wherein the compliance monitoring system is implemented by one or more of the trading computers.

12. A method of generating compliance rules, the method comprising

generating virtual trading histories, virtual trading behaviours and/or virtual compliance rules;

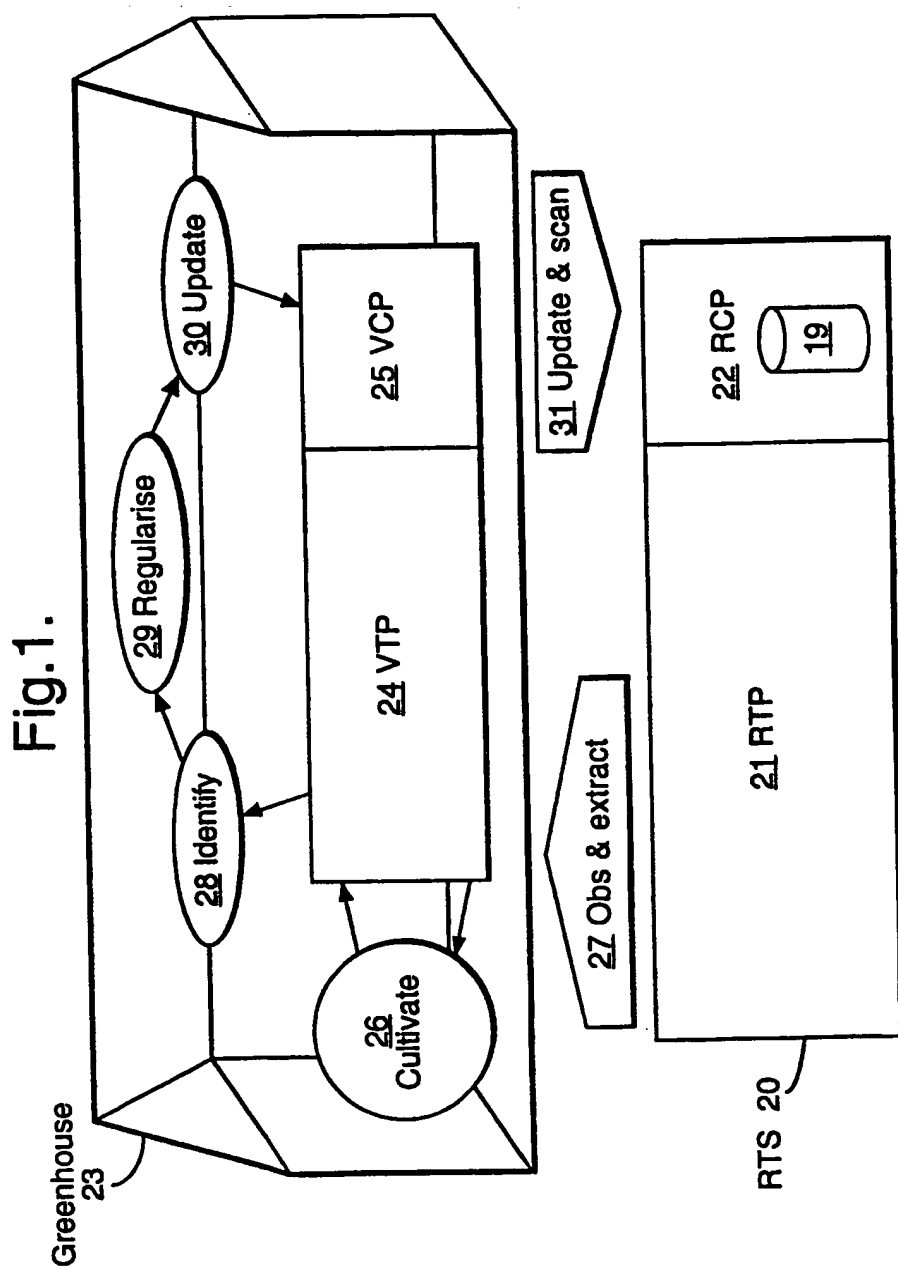**SUBSTITUTE SHEET (rule 26)**

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selecting virtual trading histories, virtual trading
behaviours and/or virtual compliance rules; and
storing virtual compliance rules in the compliance rule
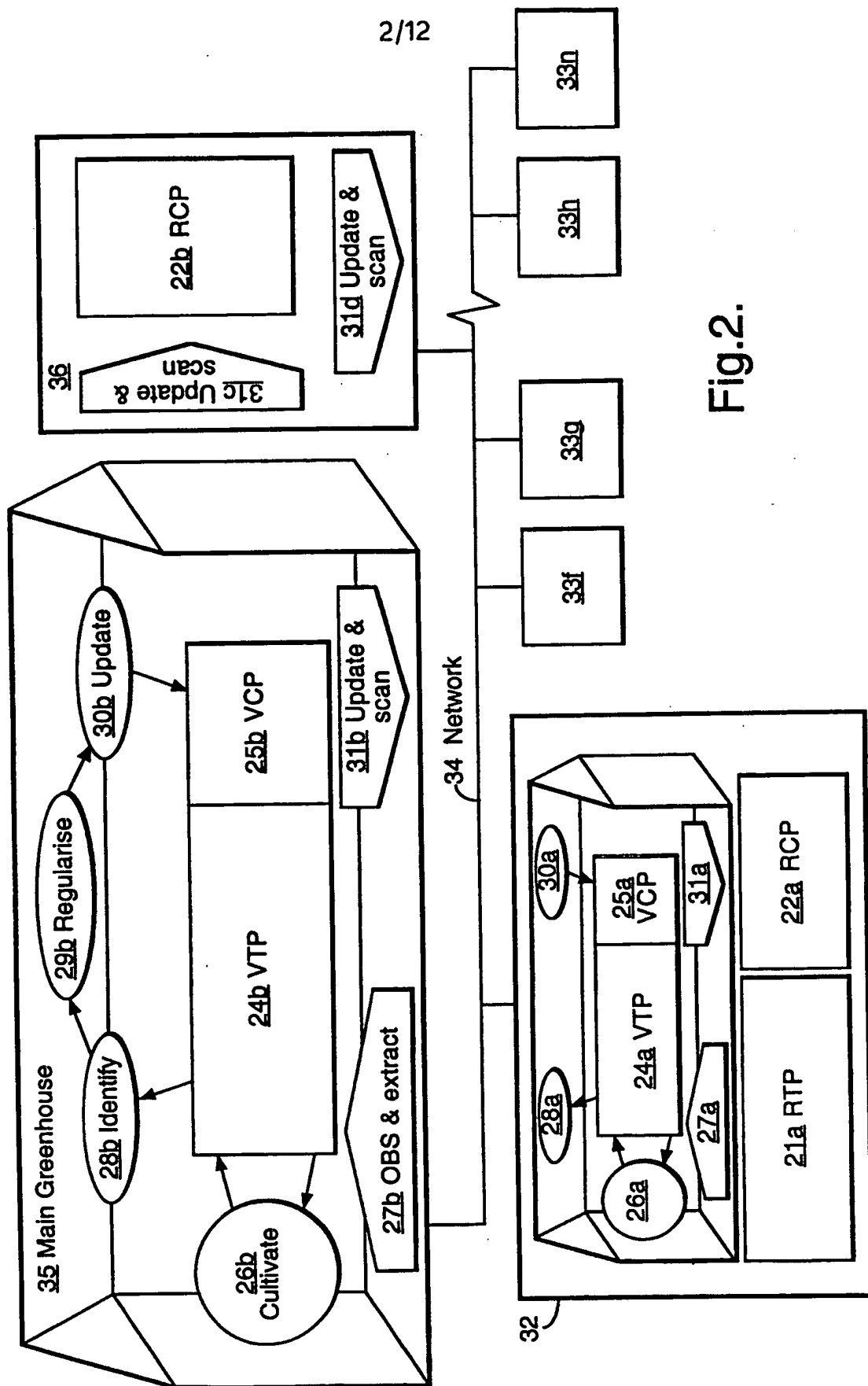memory with reference to the selected rules, histories or
behaviours.

13. A system for generating trading behaviours, the system
comprising a trading behaviour memory for storing trading
behaviours; breeding means for generating virtual trading
behaviours; growth regulation means for comparing the
virtual trading behaviours with the actions of a real
trader, and selecting trading behaviours which correspond
with the actions of the real trader; and updating means for
storing the selected trading behaviours in the trading
behaviour memory.

14. A system according to claim 13 wherein the growth
regulation means selects virtual trading behaviours by
monitoring the performance of the virtual trading
behaviours in a virtual trading system, and selecting
virtual trading behaviours which make money in the virtual
trading system.

15. A method of generating trading behaviours, the method
comprising generating trading behaviours; comparing the
trading behaviours with the actions of a real trader;
selecting trading behaviours which correspond with the
actions of the real trader; and storing the selected
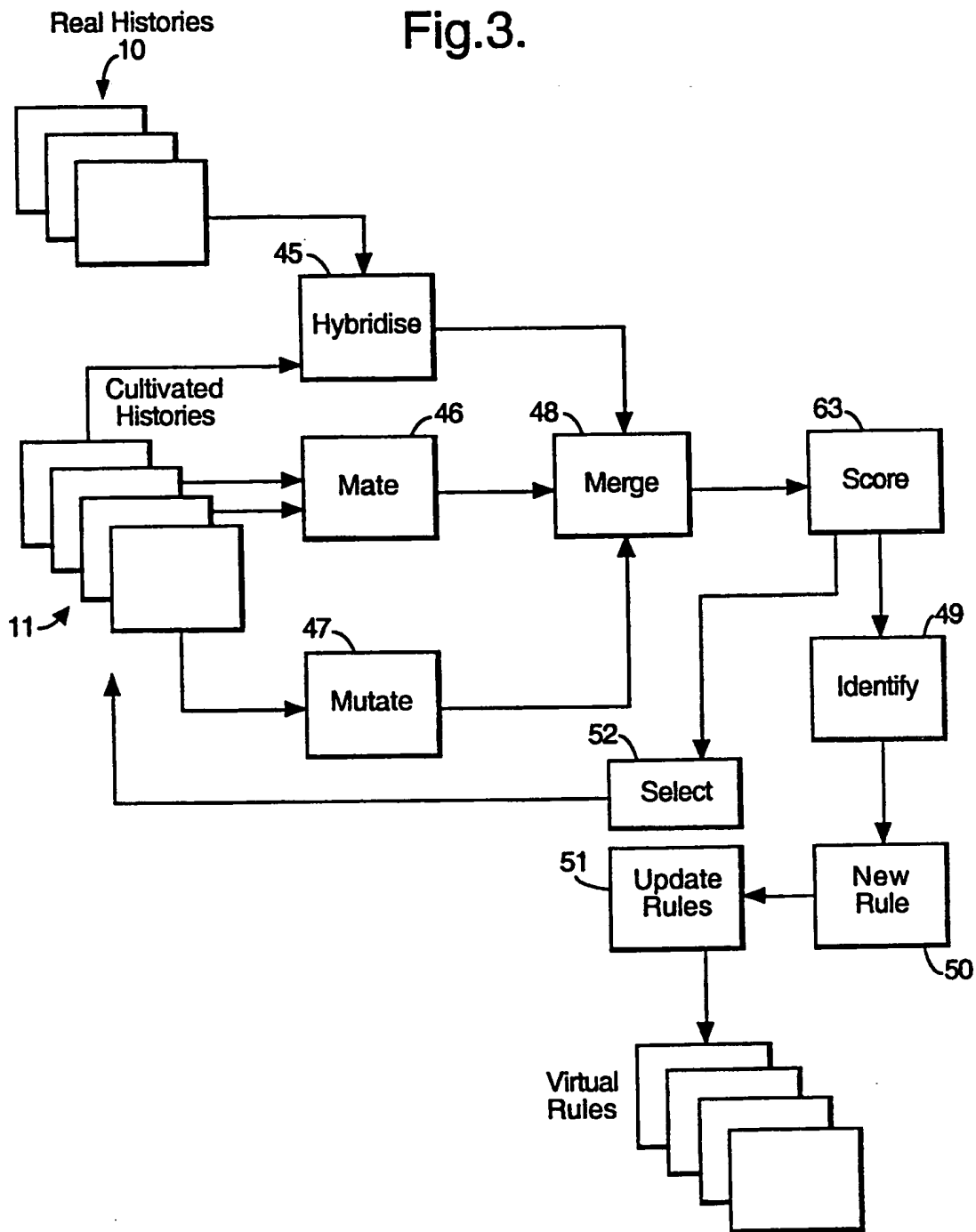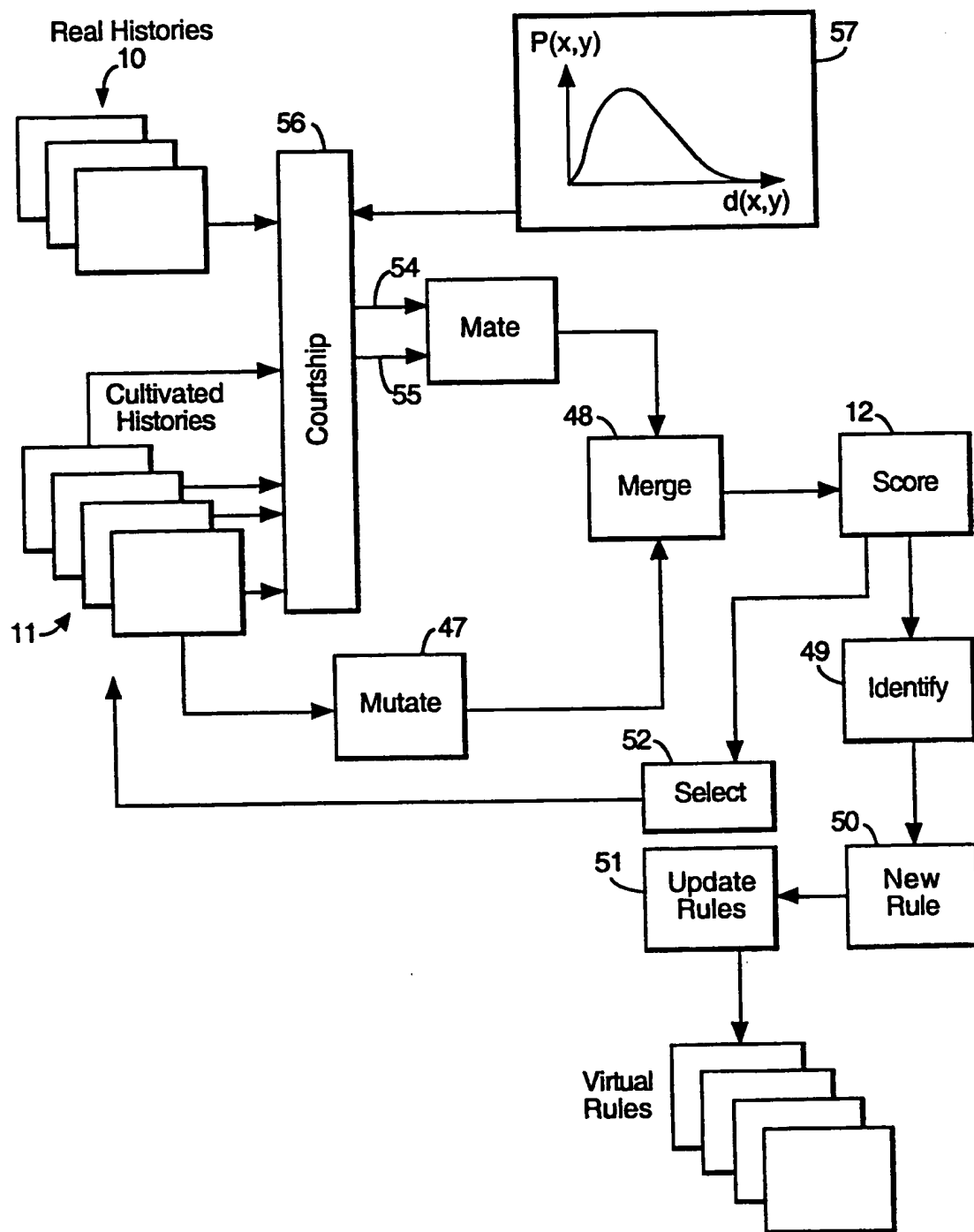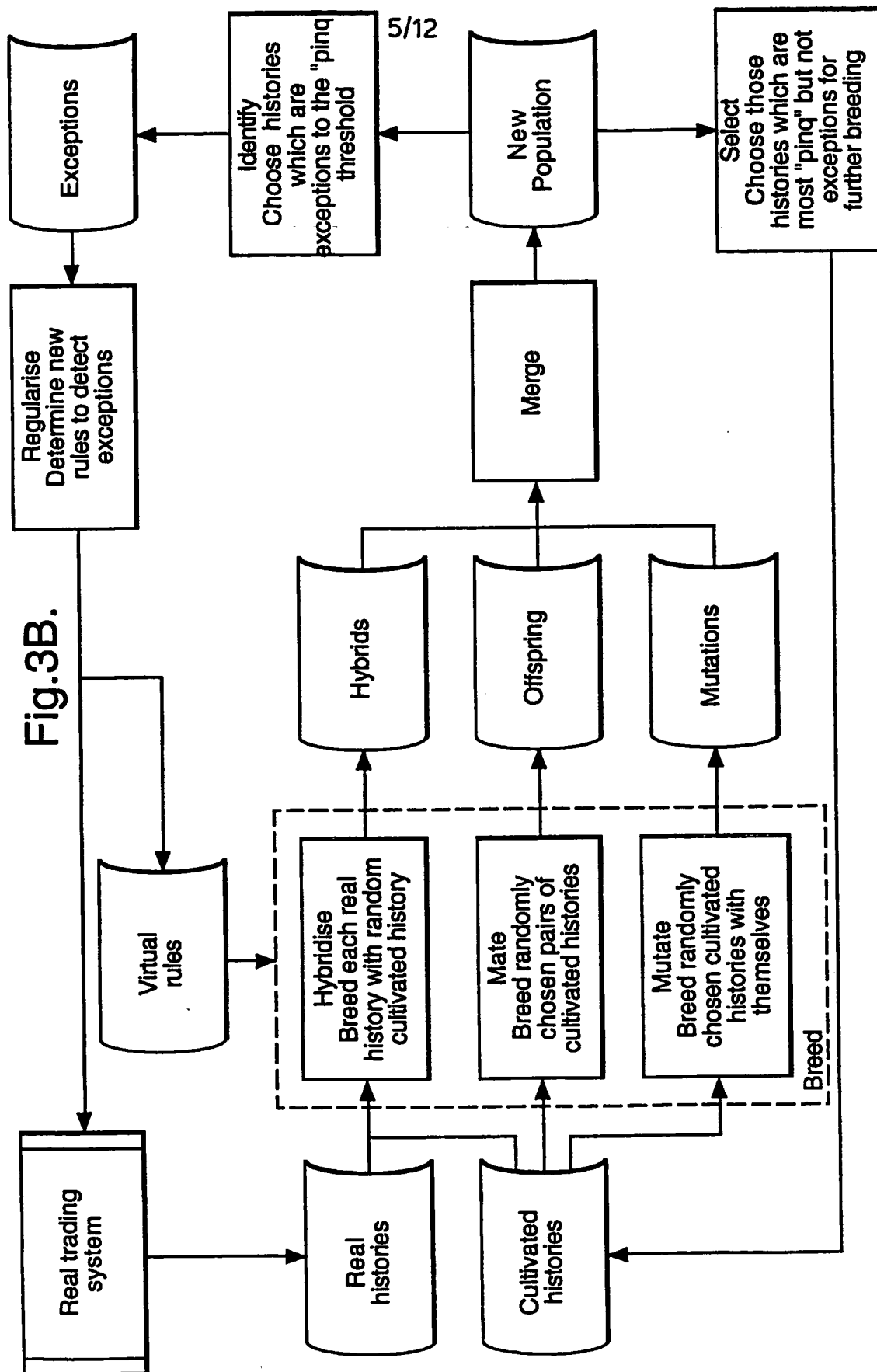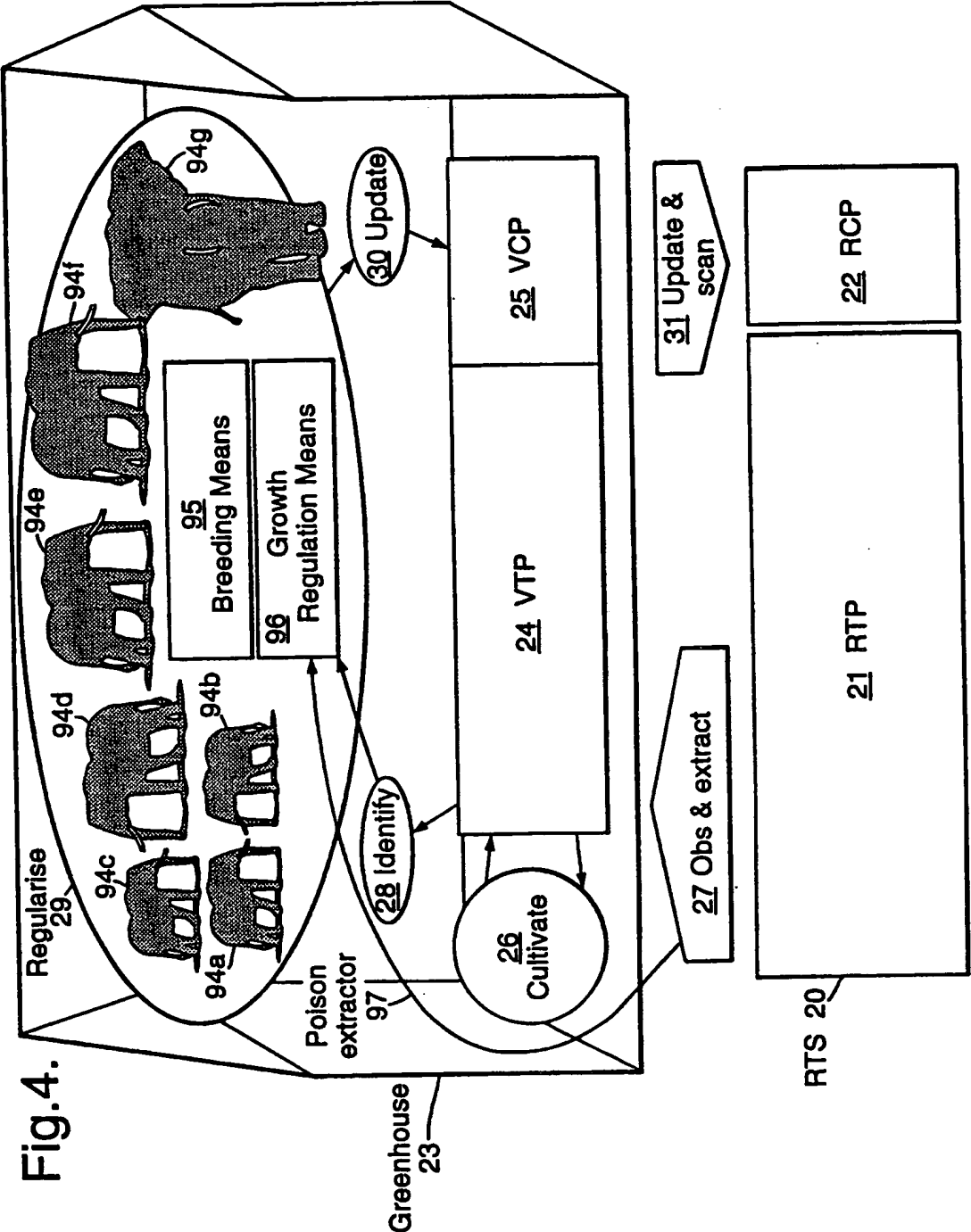trading behaviours in a trading behaviour memory.

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Fig.1.

Fig.2.

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Fig.3.

Real Histories
10

Hybridise 45

Cultivated
Histories

11

Mate 46

Mutate 47

Merge 48

Score 63

Identify 49

Select 52

New
Rule 50

Update
Rules 51

Virtual
Rules

Fig.3A.

Fig.3B.

Exceptions

Identify
Choose histories
which are
exceptions to the "pinq"
threshold

New
Population

Select
Choose those
histories which are
most "pinq" but not
exceptions for
further breeding

Regularise
Determine new
rules to detect
exceptions

Merge

Hybrids

Offspring

Mutations

Virtual
rules

Hybridise
Breed each real
history with random
cultivated history

Mate
Breed randomly
chosen pairs of
cultivated histories

Mutate
Breed randomly
chosen cultivated
histories with
themselves

Breed

Real trading
system

Real
histories

Cultivated
histories

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Fig.4.

Fig.5.
Compliance Rules &
Trading Strategies

95
E Breeding Means

96   E Growth
Regulation Means

98 T Growth Regulation
Means

99
T Breeding Means

94g
94f
94e
94d
94b
94c
94a
97f
97e
97d
97c
97a
97b
100a
100b
100c
100d

30 Update

101 Pinq Histories
102 Real Histories
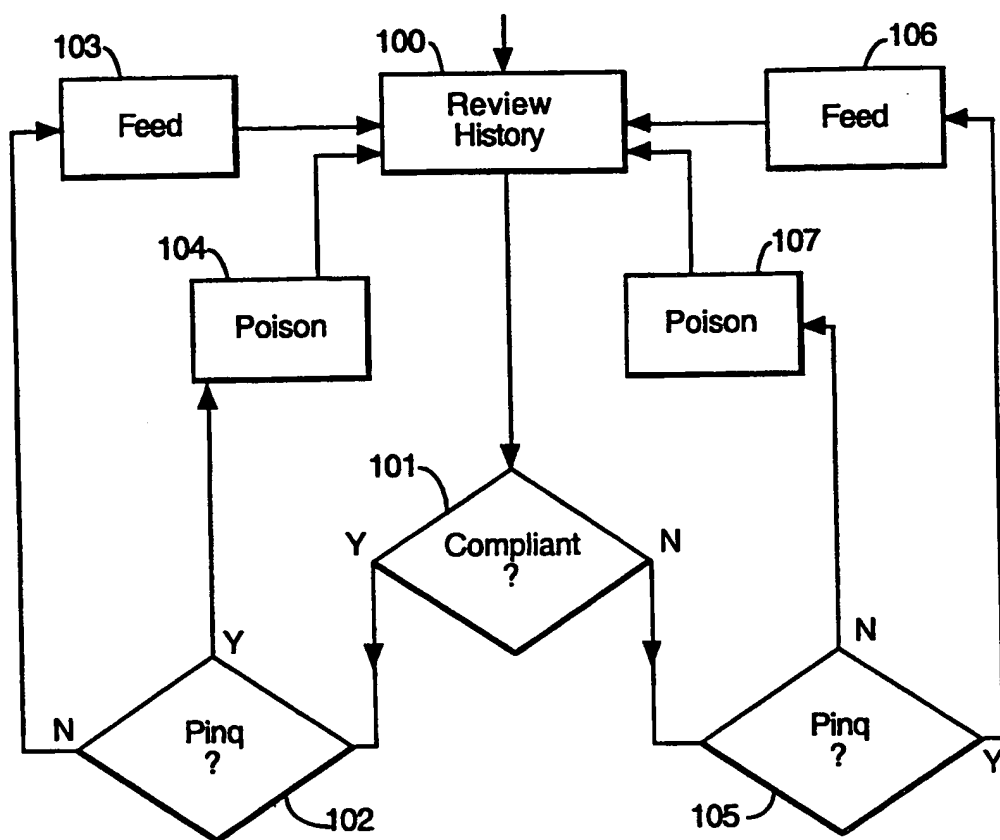103 Tiger Genes
104 Buffalo Genes

Fig.6.

Fig.7.
Details of Breed Function

Fig.8.
Example of Crossover Function
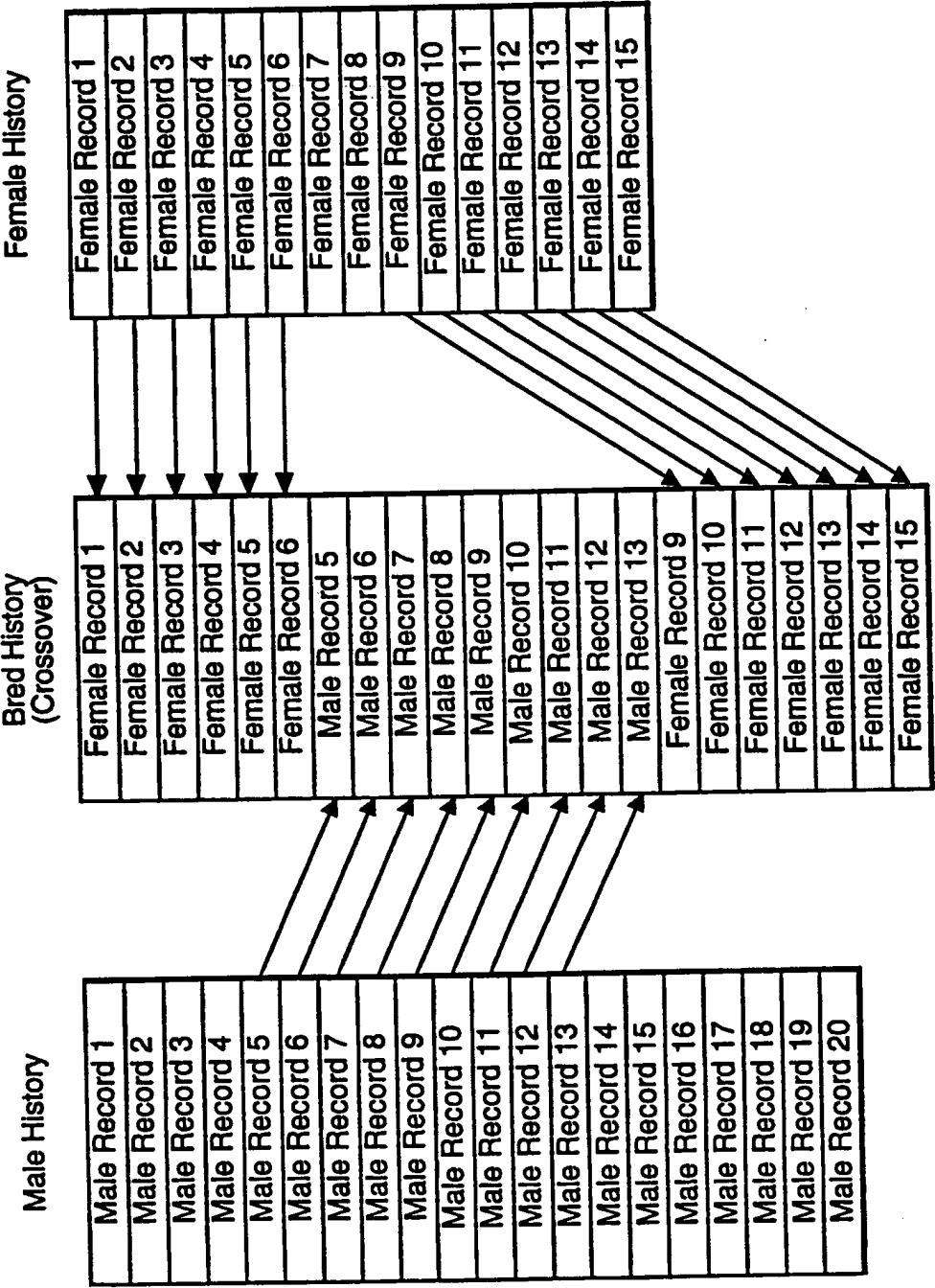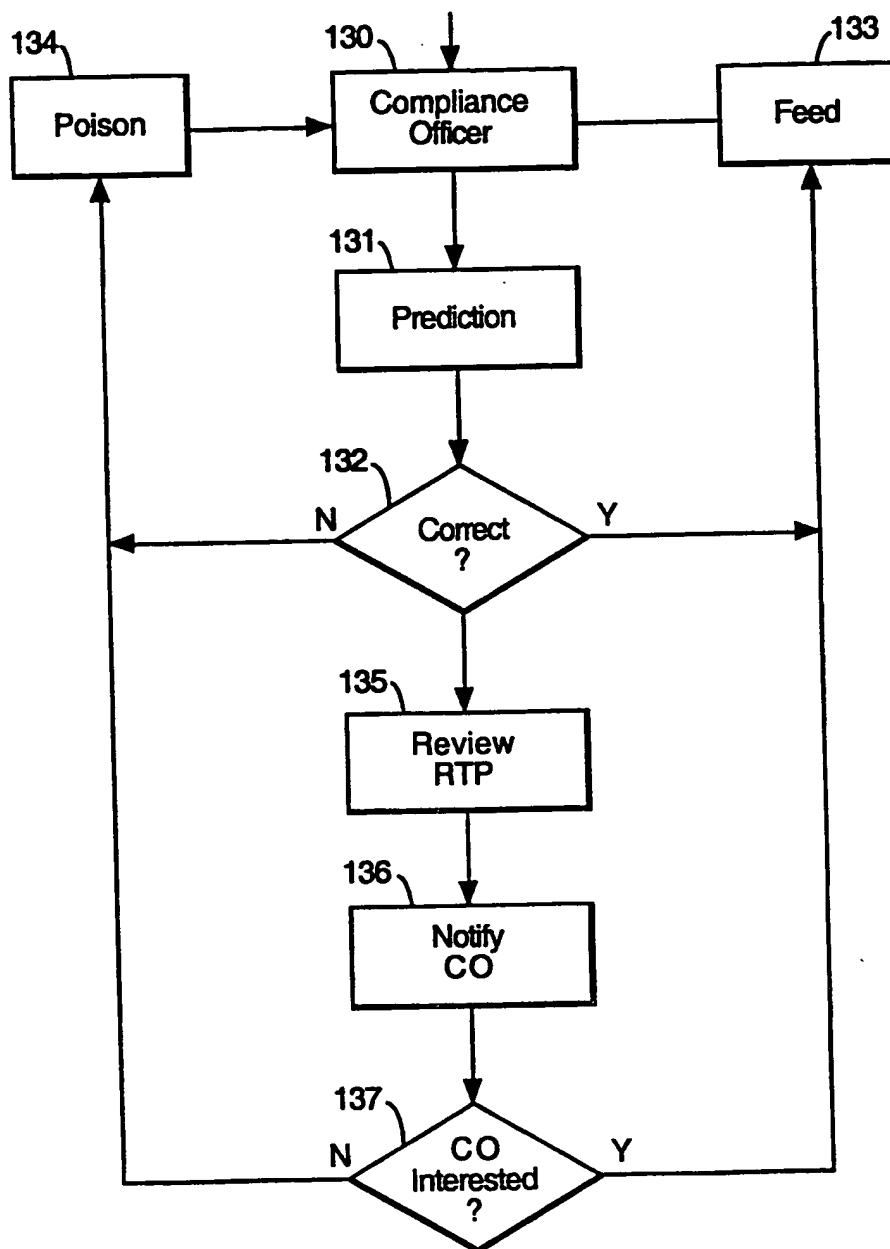
Fig.9.

Fig.10.
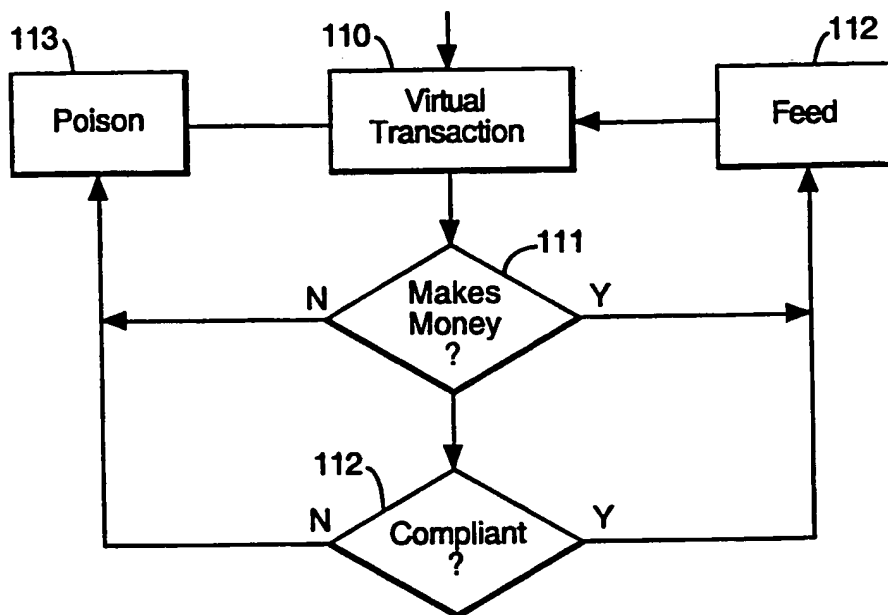
Fig.11.
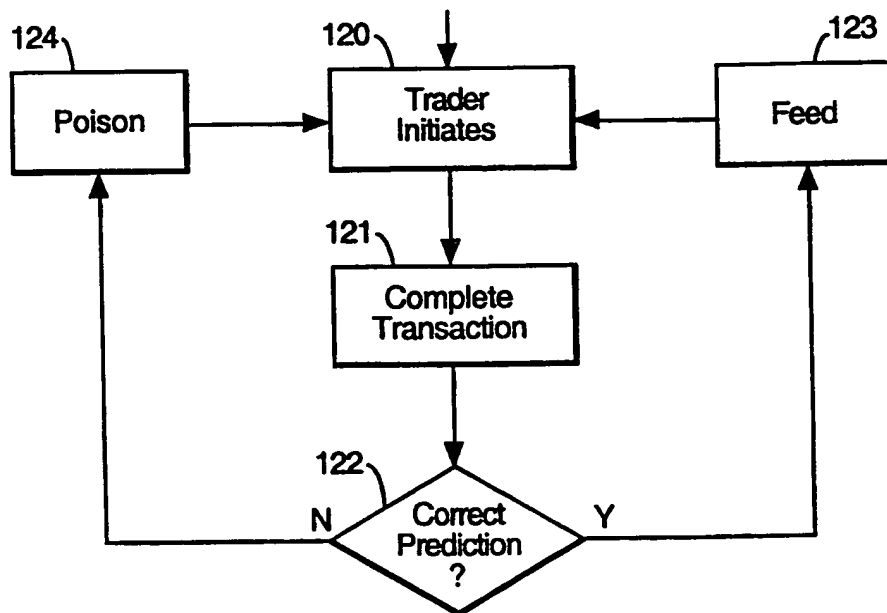
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Fig.12.

INTERNATIONAL SEARCH REPORT

A. CLASSIFICATION OF SUBJECT MATTER
IPC 6   G06F17/60

According to International Patent Classification(IPC) or to both national classification and IPC

B. FIELDS SEARCHED

Minimum documentation searched (classification system followed by classification symbols)
IPC 6   G06F

Documentation searched other than minimum documentation to the extent that such documents are included in the fields searched

Electronic data base consulted during the international search (name of data base and, where practical, search terms used)

C. DOCUMENTS CONSIDERED TO BE RELEVANT

Category °	Citation of document, with indication, where appropriate, of the relevant passages	Relevant to claim No.
A	EDMONDS A N ET AL: "Genetic programming of fuzzy logic production rules with application to financial trading" NEURAL NETWORKS IN FINANCIAL ENGINEERING. PROCEEDINGS OF THE THIRD INTERNATIONAL CONFERENCE ON NEURAL NETWORKS IN THE CAPITAL MARKETS, PROCEEDINGS OF THE 3RD INTERNATIONAL CONFERENCE ON NEURAL NETWORKS IN FINANCIAL ENGINEERING, LONDON, UK, 11-13 OCT., pages 179-188, XP002036802 ISBN 981-02-2480-X, 1996, SINGAPORE, WORLD SCIENTIFIC, SINGAPORE see the whole document — -/--	1-3, 10-15

[X] Further documents are listed in the continuation of box C.   [X] Patent family members are listed in annex.

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"X" document of particular relevance; the claimed invention cannot be considered novel or cannot be considered to involve an inventive step when the document is taken alone

"Y" document of particular relevance; the claimed invention cannot be considered to involve an inventive step when the document is combined with one or more other such documents, such combination being obvious to a person skilled in the art.

"&" document member of the same patent family

Date of the actual completion of the international search	Date of mailing of the international search report
6 October 1998	14/10/1998

Name and mailing address of the ISA	Authorized officer
European Patent Office, P.B. 5818 Patentlaan 2 NL - 2280 HV Rijswijk Tel. (+31-70) 340-2040, Tx. 31 651 epo nl, Fax: (+31-70) 340-3016	Fournier, C

C.(Continuation) DOCUMENTS CONSIDERED TO BE RELEVANT

Category *	Citation of document, with indication,where appropriate. of the relevant passages	Relevant to claim No.
A	COFFEY B: "Compliance moves forward portfolio management" WALL STREET & TECHNOLOGY, SUMMER 1997, MILLER FREEMAN, USA, vol. suppl.issue, page 28, 30, 32 XP002036803 ISSN 1060-989X see the whole document ---	1,10,12, 13,15
A	US 4 903 201 A (WAGNER SUSAN W) 20 February 1990 see column 3, line 4 - column 4, line 59 ---	1,10
A	US 5 446 885 A (MOORE ALLAN R ET AL) 29 August 1995 see column 3, line 30 - column 6, line 26 ---	1,10

1

Patent document cited in search report			Publication date	Patent family member(s)			Publication date
US 4903201	A		20-02-1990	US	4980826	A	25-12-1990
US 5446885	A		29-08-1995	US	5630127	A	13-05-1997